■ POLL: CEOs ON CHINA • WESTINGHOUSE • FRED JOSEPH: INSID

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FORTUNE

NEW IDEAS FOR THE '90s

America's Best Business Thinkers Explain the Keys to Future Success

Cypress Semiconductor chief T. J. Rodgers is inventing the organization of tomorrow.

JULY 3, 1989

FORTUNE

1990s IDEAS

ABOVE: John S. Abbott caught Arthur Andersen consultant Stephen Racioppo for the story on page 48.

COVER: Ed Kashi photographed Cypress Semiconductor CEO T. J. Rodgers.

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"Total Quality is everything, it's everybody. And it *is* almost like a religion."

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"Michael Milken could solve some of the major financial problems of our lifetime."

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"He gets up and threatens to kill me if I do it again, but I throw the third pitch at his head."

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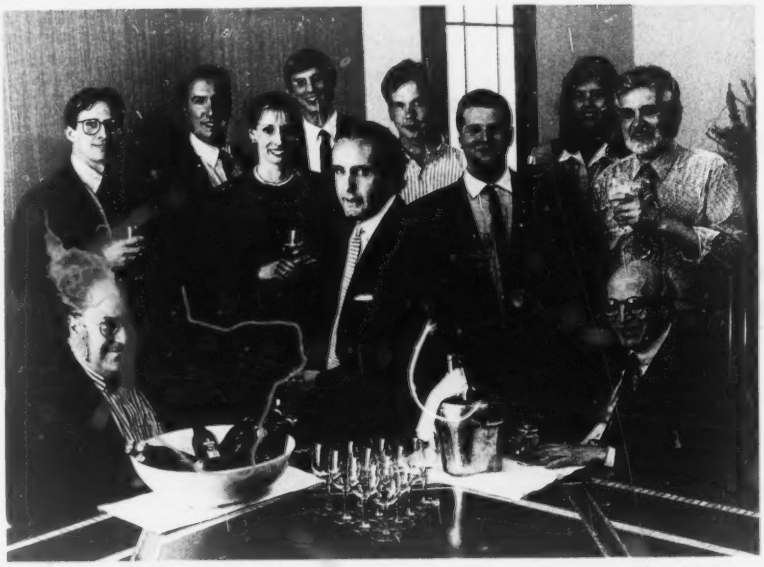

Editor Kiechel (center) and his cover-package crew celebrate the end of their labors.

DO YOU THINK you know what it will be like to manage in the 1990s? Think again. The past decade was just a warm-up. The next one, says Louis Gerstner, a former management consultant who now runs giant RJR Nabisco, will be "more competitive perhaps than we've seen in the history of modern economic society." What kind of leaders—with what kind of ideas—will light our way into the years ahead?

To answer those questions, assistant managing editor Walter Kiechel assembled a team of writers, reporters, picture researchers, and designers to produce this issue's 28-page package of cover stories. Their approach was three-pronged: "First," Kiechel says, "we wanted the best thinking of the people—many of them under 40—who will lead the charge in the 1990s. Next we sought wisdom from the battle-hardened veterans of the 1980s. And finally, we distilled the lessons passed down from the laureates in the Business Hall of Fame, stretching back to Benjamin Franklin."

Ideas? You will meet plenty here. In the lead story, writer Brian Dumaine describes how the entrepreneur on our cover, T. J. Rodgers, 41, has learned to keep innovation alive as a company grows bigger. Others talk of new kinds of "learning organizations," model managers who lead "with no apparent authority," and ways of working that blur the distinction between family life and business life. Sparks fly from Myron Magnet's interviews with 11 leaders of the Eighties ("The business community is a major enemy of the kind of society I favor," says Milton Friedman). Walter Guzzardi then draws enduring principles from such homely examples as how Ray Kroc thought about a hamburger.

Magnet sums up the virtue of looking ahead: "You can't foresee the future, but that doesn't make predictions meaningless. The future doesn't just happen. People make it happen. So what they think the future is going to be determines to a significant extent what it is."

Fortune Forecast does not appear in this issue; the 18-month economic outlook will be published in the next issue.

Marshall Loeb
MANAGING EDITOR

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READY TO RIDE OUT CHINA'S TURMOIL

The Chinese—and the Russians—are headed toward market economies, say America's top corporate chiefs. Helping them get there will be difficult, but worth it. ■ *by Alan Farnham*

DESPITE the bloodshed that has stained China in recent weeks—and despite continuing political ferment in the Soviet Union—U.S. chief executives view both nations as vast, potentially valuable markets for American goods and services. Moreover, CEOs believe both economies will evolve over the next five years into more open, market-driven systems. This evolution may take longer than previously thought, or may come at the cost of fratricide, they say, but that makes it no less inevitable.

These findings come from the latest FORTUNE 500/CNN Moneyline CEO Poll, conducted by the independent opinion research firm of Clark Martire & Bartolomeo. The respondents, 183 CEOs of FORTUNE Industrial 500 and Service 500 companies, were interviewed between May 30 and June 7. Chinese troops began their crackdown on students in Beijing's Tiananmen Square in the middle of that period, but that scarcely altered the CEOs' outlook for the long term.

"Recent events haven't changed our feelings about the long-run potential of China," says Allen Jacobson, chairman of Minnesota Mining & Manufacturing. "They're certainly a setback. We feel very sad about what has happened, for its effect

One man against the military in Beijing: FORTUNE 500 CEOs are betting that democratic forces in China will ultimately prevail.

Q A **In light of recent political events in China and the Soviet Union, do you expect these countries to become more attractive markets, less attractive, or not to change?**

	CHINA		SOVIET UNION
CEOs surveyed before crackdown		After	
More attractive	55%	53%	89%
Less attractive	5%	17%	–
No change	23%	9%	10%
Not sure	17%	21%	1%

Q A **Do you expect the Chinese and Soviet economies to be significantly more market oriented or less market oriented five years from now?**

	CHINA		SOVIET UNION
CEOs surveyed before crackdown		After	
More market oriented	81%	73%	93%
Less market oriented	2%	4%	–
No change	4%	6%	3%
Not sure	13%	17%	4%

"When you start to make an investment in a country, you're looking for reliability."

WILLIAM J. ALLEY
American Brands

"We feel very sad about what's happened in China. But I'm still optimistic."

ALLEN F. JACOBSON
3M

on the students involved, for how it may slow modernization of the economy, and for how it changes people's perception of doing business there. But we're not changing our plans. I'm still optimistic."

William Esrey, head of United Telecommunications, a long-distance and local phone company, agrees: "The conflict hasn't changed my fundamental thinking. It's a temporary blot that highlights how fragile building new relationships can be." He feels the immediate effect of the unrest will be to diminish U.S. firms' willingness to make deals in China without guarantees up front—a change that would slow development in cash-poor China.

Why are business leaders upbeat? Under the economic reforms of the past decade, China's GNP has been growing more than 10% a year, and some provinces have seen living standards double. For these reasons Sara Lee chief John H. Bryan Jr., like many respondents, feels reform's momentum has grown too powerful to be stopped: "I can't imagine that the administration that brought the reforms this far is going to say, 'Oh hell, let's move back to Maoism.' " He intends to proceed with efforts to establish Sara Lee brands in China, where the company sells cookies, and in Russia, where it sells coffee in luxury shops that accept only hard currency.

American Brands CEO William Alley bases his long-term optimism on the present crisis itself, which he expects to precipitate Chinese government decisions that might ordinarily take years. "Many of us have experienced some degree of holding back as to how far we'd go in doing business with China," he says. "Our hope is this will clear up some of the feeling of uncertainty. When you start to make an investment in a country, you're looking for reliability. There's an element here of their having to sort out their own house."

So much for optimism. In the short term, say CEOs, U.S. firms in China should rig for heavy weather. After the chaotic violence that began June 3, respondents became markedly grimmer about near-term prospects. While a majority still expected China to become a more attractive market eventually, the percentage of CEOs who expected China to become less attractive was more than triple the number who felt that way before the government crackdown. The percentage saying they expected China to become less market oriented in the next year jumped ninefold. And more than half said China's brush with civil war had caused them to adopt a wait-and-see attitude or to put projects on hold.

Charles Hugel, chairman of Combustion Engineering and the U.S.–China Business Council, a group of businessmen, says, "China will sort itself out and get back to where it was before." But in the meantime, he cautions, "companies that require central government approval could have problems short term." Hugel has experience not just with the Chinese but with the Soviets as well, becoming an every-other-month commuter to Moscow to look after an instrument-manufacturing joint venture. Like most poll respondents, he views the situation in the U.S.S.R. as fundamentally different from that in China, where economic reforms have raced ahead of politics. In Russia, Gorbachev has reformed politics without doing much to democratize the economy.

Respondents didn't see China's troubles as rubbing off on the Soviet Union, and 93% believe Russia will become more market oriented in the next five years. How will it get there? The executives said making rubles convertible to dollars would help.

"Companies that require central government approval could have problems short term."

CHARLES E. HUGEL
Combustion Engineering

"Convertibility of the ruble is a subject under much debate in the U.S.S.R.," says Hugel. "There are hundreds of different conversion rates within the Soviet Union. The government has to deal with that problem before it can deal with matching the ruble to the rest of the world."

Esrey of United Telecom wants to see the Soviets shift more resources from the military to the civilian sector. Soviet Premier Nikolai Ryzhkov last month seemed to take a giant stride in that direction when he announced military spending might be cut by as much as a third by 1995 in an effort to spur the domestic economy.

Jack MacAllister, CEO of US West, which is looking into laying fiber-optic cable the length of Russia, feels confident the Soviet government means business. "The Soviets are deadly serious about building a market-based, free economy," he says. "They could have made it very difficult for us, but they've given us all the information we needed. Here are a people who have decided they want to join the world." F

REPORTER ASSOCIATE *Constance A. Gustke*

Q A

What changes could the governments of the Soviet Union and China make that would most attract you to do business in these countries?

	CHINA		SOVIET UNION
	CEOs surveyed before crackdown	After	
Reduce bureaucracy	16%	19%	18%
Increase political stability	15%	21%	5%
Make currency convertible	14%	9%	25%
Make government more democratic	13%	9%	–
Increase the society's openness	13%	9%	17%

HOW TO SUCCEED IN A LOUSY BUSINESS

The savings and loan business, that is. If you can make it there, you can make it anywhere. But some patient plodders are doing just that by sticking to their knitting. ■ *by John F. Lawrence*

We're what a savings and loan should be. We take your money and pay you a certain amount of interest on it, and then we reinvest that money in a very good way: We help people buy houses. We do these two simple things that make a savings and loan a savings and loan.

—Commercial for Home Savings

THEY WERE CALLED dinosaurs awaiting the next ice age—savings and loans that acted like the commercial and refused to diversify, to join the new game of risk taking, to force-feed growth the way Charlie Knapp did as CEO at First Charter Financial in California, making it for a time the biggest S&L.

The description was misapplied. The ones that sank into the tar pits were First Charter and hundreds of S&Ls chasing growth by any means. The problem was compounded as state authorities seemingly chartered every S&L that someone politically well-connected wanted to start. Often the founders had little more in mind than amassing cash they could lend to friends. While the new breeds were coming to grief, the patient plodders—the behemoths that did mostly what they always did—became the survivors. Despite growing competition from commercial banks and mortgage companies, they could still dominate the business of making home mortgages in the years ahead.

With federal authorities taking over so many failing institutions, it appears as though this whole industry needs bailing out. S&Ls lost $30 billion in savings deposits in the first quarter, 3% of the industry's total. Higher interest rates are attracting money to other investments, and savers worried about the industry are deserting it. Out of nearly 3,000 institutions, approximately 250 are considered insolvent, and another 1,300 only marginally healthy.

REPORTER ASSOCIATE *J. B. Blank*

Great Western Financial's CEO James Montgomery: "We're in a growth business."

But that leaves about 1,400, including the bulk of the big ones, in solid shape. Some 15% of those have made themselves downright robust in the past few years (see table for five of the strongest) and continue to gain in vigor. How they do it is exemplified in the stories of two large S&Ls, California's Home Savings, which gained a record $807 million in deposits in March, and Great Western Financial, which picked up $200 million that month. They are prime examples of what S&Ls were in the old days—and can be again if Congress and the Bush Administration make the right moves. They turn a profit making loans, holding loans, and servicing loans after they've sold them to other investors. They should be able to survive even full deregulation of banking and head-to-head competition with full-service banks.

Their success attests to an aphorism regaining favor around business schools: Stick to your knitting. The Knapps of the world thought S&Ls could compete in an age of deregulation only by being mostly something else. The sensible S&Ls concentrated on their core business.

HOME, owned by H.F. Ahmanson in Los Angeles, leads the industry with $40 billion in assets; it is second to Great Western in profits. It made $14.9 billion in mortgage loans last year, beating Citibank and Great Western for the top spot. Home and Great Western together account for 7% of

PHOTOGRAPHS BY ALAN D. LEVENSON

the single-family home mortgage market.

Security analysts applaud these two and a few others for having built such solid balance sheets that they can borrow short-term money more cheaply than some big-name banks. Analysts even recommend their stocks. Says Allan Bortel of Shearson Lehman Hutton: "These two companies are selling at three-quarters of average P/E multiples for the overall market, with better earnings and less risk."

The question now is what uniform U.S. policymakers will permit these strong players to wear—S&L gray or banker pin stripe—and how badly they'll be penalized for staying in the game. Federal Reserve Chairman Alan Greenspan says that S&Ls may have outlived their usefulness. Those with his view believe that commercial banks and mortgage companies can meet the needs of the housing industry and that S&Ls should be folded into banks. These critics think a separately regulated S&L business, with arcane but real tax incentives for making home loans, may be a disastrous anachronism in an age of full-service banking.

The Bush Administration's bailout plan, now moving through Congress, would nonetheless keep a separate S&L industry in existence, making S&Ls pay more than banks for federal insurance. S&L leaders argue that the extra costs penalize sound institutions that are not responsible for the industry's mess. Though the bill would lower the differential over time, there is no assurance that it would produce parity.

Home's Richard Deihl: Service attracts customers.

WHAT'S INDISPUTABLE is that the strong S&Ls make up a viable business with a loyal corps of customers and an important service to perform. Home and Great Western are only the largest examples. A little further down the list, World Savings, owned by Golden West Financial of Oakland, boasts a compound earnings growth rate of 20% over 20 years. Says Golden West Chairman Herbert Sandler: "What's all the talk that you can't make money lending on residential real estate? That's all we do!" And there are examples near the bottom of the list—hundreds of old, one-community outfits like Workingmens Federal of Bloomington, Indiana, with $130 million in assets. It has been in business since 1885 making mortgage loans strictly close to home. Such S&Ls don't have to get into commercial loans and push other financial services to stay healthy.

Powerhouses like Home and Great Western have built unparalleled retail machines for collecting low-cost deposits and competing for quality home loans. They excel at drumming up business and achieving maximum cost savings from high volume. They've taken advantage of deregulation to extend beyond California—which itself accounts for 17% of U.S. housing starts. Home has loan offices in 19 states and full S&L branches in nine, including New York, where it owns Bowery Savings Bank. Great Western has offices in 20 states, branches in five. Its loan agents, most drawn not from financial backgrounds but from sales-oriented industries like office equipment, compete for quality loans by staying in close touch with real estate agents.

Would-be home buyers no longer come hat in hand to the corner S&L hoping to get a loan—the big S&Ls now go out and find *them*. The loan agents make lots of money—many earn $100,000 to $200,000 or more in a good year—and their reputations ride on the quality as well as the quantity of the loans they produce. With efficient underwriting and approval staffs behind them, they can offer real estate agents quick approval and funding when speed is essential to closing a deal. "It's how efficiently you handle a loan that gets you another," says Joe Daher, a 25-year-veteran agent for Home who arranged 260 loans worth $77 million last year.

USING COMPUTERS, the home offices keep watch on loans in process and on the books. Home's loan losses run 0.14% of its portfolio. That's up from 0.06% two years ago, reflecting the problems that have plagued many of the S&Ls that made loans in Texas (and killed lots of Texas-based institutions). But it's far from the 1.13% industry average.

Volume spreads the overhead. Home and Great Western make enough loans not only for their own portfolios but also to sell to investors. In recent years they've developed many new buyers, including pension funds, and now talk of packaging loans in ways that will appeal to foreign investors. Volume also sustains a profitable loan-servicing business. The institutions generally keep the billing and other servicing work on loans they sell, collecting a fractional share of the interest.

The trick on the other side of the business is to lure savings depositors without having to pay premium rates and brokers' fees. One apparent competitive disadvantage for S&Ls, the high cost of maintaining branches, is actually an advantage. Branches mean personal service to customers. And while young people may go for quick, one-stop banking service, they aren't the big savers: Some 65% of S&L deposits come from savers 55 years and older. These folks with nest eggs are willing to spend some time with their money and delight in visiting an S&L branch to do it.

Successful S&Ls offer convenient branch locations and superlative service. Most of the big ones, including Home and Great Western, market most aggressively in California and Florida, with their large retirement populations. Since tellers are the savers' most frequent contact with the S&Ls, both companies pay considerable attention to hiring, motivating, and retaining the people behind the counter—by rotating them into less tedious tasks like opening new accounts, for example.

Home and Great Western hammer consistently on their main marketing theme: service and safety. Great Western used John Wayne as its spokesman, and after his

death, Dennis Weaver. Last December it agreed to pay Jerry Buss, owner of the Los Angeles Forum, close to $4 million a year to rename the home of the basketball Lakers and hockey Kings the Great Western Forum.

The strong name recognition pays off. Great Western gets 98% of its deposits directly from savers rather than through brokers, and Home gets 100%. The two even have customers who stubbornly prefer the simplicity of keeping their money in ordinary passbook accounts paying a mere 5% to 5.5% (8% of Home's customers do so, the new loans to skeptical borrowers. Then, prepared to give up some growth, he defied competitors that still offered fixed rates and refused to make anything but ARMs.

His agents, backed by strong loan underwriting and processing staffs, built volume from $382 million in the depressed housing market of 1981 to $14.9 billion in 1988. (Deihl reintroduced a fixed-rate loan only last year, confident that his sales force will still get most customers to choose the ARMs.) Nearly 90% of Home's portfolio is in adjustable-rate loans. As a result the company "can just sit and do nothing" and make

FIVE LEADERS IN SIZE AND STRENGTH

COMPANY	ASSETS* (millions)	5-YEAR % CHANGE	DEPOSITS* (millions)	5-YEAR % CHANGE	EARNINGS* (millions)	5-YEAR % CHANGE
H.F. Ahmanson	$40,095.7	70.1%	$29,505.5	59.1%	$208.7	340.3%
Great Western	$32,815.2	34.6%	$22,207.1	25.9%	$248.4	194.0%
HomeFed	$17,008.7	93.2%	$12,208.3	82.7%	$111.3	112.0%
Golden West	$16,721.0	59.2%	$10,496.2	40.7%	$138.3	93.4%
Dime Savings Bank	$12,007.2	71.9%	$8,723.3	35.1%	$80.1	**

*For year ended Dec. 31, 1988. **Loss in 1984.

Ranked by assets, the list represents the best of the big publicly traded S&Ls in terms of both growth and overall strength. All have tangible net worth of at least 3.8% of assets.

and 5% of Great Western's). The two institutions thus have a tremendous cost advantage over troubled S&Ls, which often get over half their deposits through brokers. Home and Great Western have a long way to go to catch banks in attracting the cheapest source of funds—checking accounts—but those are slowly growing as well.

The S&Ls have solved the problem that almost crippled them in the 1970s by turning heavily to adjustable-rate mortgages. Before deregulation legalized such loans in 1981, the S&Ls were squeezed between what they had to pay depositors as money market rates rose and what they earned on their fixed-rate, 30-year mortgages. Home and Great Western have been among the most aggressive in persuading home buyers to take ARMs.

Home's chairman, Richard Deihl, whose lean and hungry look seems to reflect his former career as a business machines salesman, did it by firing up his sales force—Home's loan agents. A loan agent himself after he left NCR and started with Ahmanson in 1959, he put the troops through a rigorous training program so they could explain the complexities and advantages of money, as he puts it, even if rates generally rise and the S&L has to pay more for deposits. Last year Home earned more than $200 million "doing nothing." Says Deihl, who at 60 is already in his third decade as CEO: "It's a nice feeling compared with 1981, when we realized that if we just sat there, we'd be out of business in 17 months."

BORROWERS generally pay a percentage point or so less on ARMs than they would on fixed-rate loans because the ARMs are less risky for the lender. Deihl figures that even with the run-up in rates of the last year or so, most of Home's ARM customers are still paying less than they would have if they had taken out fixed-rate loans in the past few years. Yet Home's spread between cost of funds and return on assets has remained consistently above 2.3 percentage points, vs. 1.9 points for the industry as a whole. Great Western, which has placed similar emphasis on ARMs, has maintained a spread of about three points. Both have succeeded in selling service more than rate. Borrowers usually can find a lower adjustable rate down the street, but not as quickly or reliably.

The two industry giants haven't entirely avoided diversification. A Home customer can find a brokerage service in the branch, for instance, but the institution isn't out to become a serious factor in that business. James Montgomery, 54, a former Price Waterhouse accountant who has headed Great Western since 1979, bought a profitable consumer finance company and began to aggressively push credit cards. But after gearing up to go into commercial lending, he got a look at the first loans offered and scrapped the whole project. Why lend on anything without a nice piece of property as collateral? He also decided against buying troubled S&Ls offered up by regulators, one reason his company is the most profitable.

Montgomery, who bears more than a passing resemblance to his late spokesman and sports a Laker championship ring given him by Buss, says he can expand Great Western's loan volume and other business by 10% to 15% a year while holding expense increases to less than 10%. Says he: "We're in a growth business and our traditional competition [a lot of other S&Ls] is disappearing."

A certain amount of that growth will come from banking—Great Western already calls its branches banks—but Montgomery doesn't pretend the company will be more than a special-purpose bank focused on mortgage lending. "I'm creating better-quality assets than the banks anyway," he says, referring to the flexible returns from the ARMs and the security of lending on homes.

Like most of their strongest competitors, Home and Great Western will get some help from the Bush bailout plan. With a lot of sick S&Ls out of their misery, the strong ones won't be competing for funds by offering the high rates the desperate ones have been forced to pay to struggle along. Those extra costs now keep Home's and Great Western's deposit expenses about a half percentage point above what they would be otherwise. If the two could save even 70% of that, they could increase their earnings by roughly 25%. Less profitable S&Ls would get an even bigger percentage boost. The extra insurance costs will continue to be a handicap. But by clearing away the opportunists in the business, the bailout will go a long way toward letting the survivors—the ones that know how to do those "two simple things that make a savings and loan a savings and loan"—compete on their own merits in the marketplace. F